In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 793

JOHN S. FOWLER AND JIMMIE LEA FOWLER,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioners, husband and wife, were found guilty by a jury of having wilfully attempted to evade and defeat their income taxes. The husband was sentenced to ninety days' imprisonment, placed on probation for two years thereafter, and fined $2,000; the wife was placed on probation for two years and fined $2,000 (Pet. App. 17a).

The government's case was based upon the net worth method of proof.[1] It was considered necessary

[1] There is no legal basis for petitioners' suggestion (Pet. 7) that the net worth method of proof must be corroborated by the bank deposits or any other method of proof. Moreover, petitioners neither claimed nor showed any prejudice from the fact

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to use this method because petitioners' bank deposits far exceeded their reported gross receipts (IV R. 475), and their books reflected neither their operation of a restaurant during portions of 1958 and 1959 (IV R. 483) nor income from the sale of real estate and stock or interest (IV R. 484). Moreover, petitioners had many large currency transactions which did not appear on their books (V R. 511–514), and they regularly used cash register money for unrecorded personal expenditures (V R. 523). In each of the prosecution years, petitioners' income tax returns were prepared by a C.P.A. on the basis of petitioners' incomplete books (III R. 123–125).

In determining a starting point for the net worth computation, the government began with a balance sheet submitted by petitioners to the Small Business Administration in support of an application for a $40,000 loan in 1955. As a result of his exhaustive independent examination of petitioners' net worth at that time, however, the examining agent increased their net assets for the starting point by more than $20,000 (IV R. 470–474). He also searched all leads for non-taxable receipts and, consequently, gave petitioners credit for an unreported condemnation award, insurance claim proceeds, and the cash surrender value of two insurance policies (IV R. 461–463). Petitioners had not claimed any large cash hoard

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that the government had at one time stated it would use the bank deposits method in addition to net worth; such evidence was equally available to them, and, if it would have helped their case, they were free to introduce it themselves.

and had stated that their cash on hand would never exceed $2,000, which they allegedly needed to accommodate customers who wished to have checks cashed (IV R. 477–478; V R. 587–588). Investigation disclosed nothing inconsistent with, and tended to corroborate, this statement (IV R. 479).

Petitioners' net expenditures during the indictment years were far in excess of reported income; indeed, their personal expenditures alone exceeded the reported taxable income for each year and included amounts spent for two Cadillac automobiles (III R. 222–224; IV R. 420–423; V R. 511), a fur coat (IV R. 423–425), extensive life insurance premiums (IV R. 320–322, 410–417), vacations (V R. 523–525), and gambling losses (V R. 520–521).

From all of the evidence adduced by the government, the jury could have found (V R. 639–662) that the understatement of income was $9,253.84 for 1957, $17,238.75 for 1958, and $44,832.67 for 1959. The tax deficiencies for these years would have amounted to approximately $2,000 in 1957, $4,000 in 1958, and $24,000 in 1959 (V R. 662–666).[2]

In this Court, petitioners are essentially urging that the evidence be reweighed. Specifically, they place their reliance (Pet. 9–10) upon alleged errors in the government's net worth computation, prin-

[2] On their returns, petitioners reported taxable income of $820.90 in 1957, $147.18 in 1958, and $3,973.18 in 1959 (I R. 1–2). "Of course the government did not have to prove the exact amounts of unreported income * * *." *United States* v. *Johnson*, 319 U.S. 503, 517.

cipally what they call the "check float". The evidence showed that certain checks which were dated near the end of one year did not clear the bank until the beginning of the following year, and the claim is made that accounting for these checks as if paid in the earlier year would have materially reduced the net worth bulge.[3] We disagree. In distinguishing *United States* v. *Vardine*, 305 F. 2d 60 (C.A. 2), upon which petitioners rely (Pet. 9–10), the court below properly pointed out (Pet. App. 29a) that no evidence had been adduced in the present case to show that these checks were delivered to the payees in the year dated or whether they were used to reduce liabilities shown as existing at year's end on the government's net worth statement.[4]

Nor is there any merit to the contention (Pet. 11–13) that the evidence in the instant case did not meet the standards for net worth proof set forth by

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[3] Special Agent Brown testified that there were also floating deposits of this nature, and that, if these deposits and checks were all taken into consideration, the petitioners' understatements of income for the three years would have been increased by $177 (V R. 605–606).

[4] The opinion in *Flemister* v. *United States*, 260 F. 2d 513 (C.A. 5), also relied on by petitioner (Pet. 10), noted that the $3,500 liability allowance in issue there, omission of which was "too significant to overlook," would have reduced the taxpayer's alleged understatement by one-half (see Pet. App. 57a–58a). No such disparity is shown here.

It should be noted that, under the net worth method, no matter in what year checks are considered paid—thus reducing the taxpayer's assets—an equivalent offsetting accounting entry is made in the same year—either a reduction in the liabilities column or an addition in the nondeductible expense column.

this Court in *Holland* v. *United States*, 348 U.S. 121. It is clear that both the trial court (Pet. App. 3a) and the court of appeals (Pet. App. 31a, 34a) were satisfied that the government had shown the need for using the net worth method, had established a starting point, had shown a substantial increase in net worth for each year, had shown a likely taxable source of income, had thoroughly investigated all reasonable leads, and had shown wilfullness. This, we submit, is all that is required by the *Holland* decision.

The government's evidence of wilfullness did not depend, as petitioners assert (Pet. 12–13), upon their uncorroborated admissions. In addition to a consistent pattern of under-reporting and failure to show all their income on their books, petitioners dealt extensively in cash, failed to reveal all their income to the C.P.A. who prepared their returns and maintained a much higher standard of living than their reported taxable income (see n. 2, *supra*) could conceivably support. Certainly the *Holland* case would permit a jury to find wilfullness from such a record, and the jury here properly did so.[5]

[5] Petitioners imply (Pet. 12–13) that they were too poorly educated to have been able to form the requisite intent or to have made legally cognizable admissions. This contention was properly rejected by the court of appeals (Pet. App. 35a–37a). It is clear that petitioners were astute enough to run several very successful businesses. It is also clear (V R. 529–531; Pet. App. 36a–37a) that the investigating agent took great pains to explain petitioners' constitutional rights to them. Agent Brown testified that Mr. Fowler understood the example he gave him in explaining their constitutional rights (V R. 521).

For the foregoing reasons, we respectfully submit that the decision below was correct and that the petition for certiorari should be denied.

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REPLY TO MEMORANDUM IN OPPOSITION

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The Solicitor General defends the errors in the Government's net worth computation here involved by admitting two of them (the check float and the omitted liabilities) while ignoring the others. He would excuse the check float error, as did the Appellate Court, claiming an absence of proof that the checks were delivered within the year and adding the surmise that the checks in float may have reduced a liability reflected in the net worth computation.

An examination of these checks, the dates they were drawn, their negotiation early in the succeeding year,

the fact that they were issued in payment of routine accounts and their numbers combined to make clear that they were drawn and delivered in the ordinary course of business within the year reflected on the checks. Checks so drawn and delivered justify deduction in the year delivered. ***Estate of Modie J. Spiegel,*** 12 TC 524, acquiescence, 1949-2 C.B. 2, 3, Rev. Rule. 54-465, 1954-2 C.B. 93; and constitute income to the payee ***even though received after banking hours December 31st. Charles F. Kahler,*** 18 TC 31.

These outstanding checks were called to the attention of the Government during cross examination of its Special Agent and before the Summary Agent fashioned the net worth statement here involved. Nevertheless, this statement was not corrected to reflect this float.

This "lead", in the language of *Holland,* (348 U.S. 121, 135-136), was ignored by the Government and "when the Government fails to show an investigation into the validity of such leads, the trial judge may consider them as true and the Government's case insufficient to go to the jury." *Id.* 136.

Significantly, the Court of Appeals Second Circuit agrees with the import of this quoted language from *Holland* and disagrees with the Solicitor General on exactly this same set of facts. In *Vardine,* although the Appellate Court ***was persuaded that the taxpayer was guilty*** (305 F. 2d 60, 62), a finding that the taxpayer "had checks outstanding at the end of the years 1951, 1952, 1953 and 1954" (*id.* 65) in much smaller amounts than are here involved, was said to be reversible error.

A possible explanation of the Solicitor General's and perhaps the Eighth Circuit's tolerant attitude of error appears in the second paragraph of the fourth footnote of the Memorandum Brief in Opposition. There the Solicitor General erroneously states that no harm is done by ignoring the check float because there will be an equivalent offsetting accounting entry (a) in reduction of liabilities or (b) by way of addition to non-deductible expenditures. To apply his theory let us use the total check float outstanding as of December 31, 1957 of $4,255.70, involving twenty checks, and let us assume that $2,000.00 of these checks were for year-end bonuses to employees and $2,255.70 were for ultility and related operating expenses. It is clear in these circumstances that the liabilities and personal expenditure columns of the net worth statement *would be untouched.* Only if it is assumed that, in this illustration, $2,000.00 were paid in reduction of a debt or debts and the $2,255.70 constituted non-deductible personal expenditures could the Solicitor General be correct.

The disputed checks on their face do not bear out the Solicitor General's conclusion; his assumption is wrong and it is clear that the "lead" given to the Government at trial relative to the check float was ignored contrary to the teaching of *Vardine, Holland* and common sense.

Next, the Solicitor General in a footnote attempts to brush aside the *Flemister* rule, (260 F. 2d 513) as inconsequential because the omission of liabilities here involved was not disparate. These taxpayers complain not about a single omission but of a finding by the Appellate Court that no prejudicial error occurred

"even assuming that Appellants are correct in all matters relating to the trust fund, the loan, the automobiles and the check float." See Appendix to Petition, p. 29a. If a single omission is error in the Fifth Circuit we submit that a series of errors is reversible in the Eighth Circuit. If one omission poses a question to be fairly weighed by the Court of Appeals with respect to a taxpayer who lives in Texarkana, Texas, within the Fifth Circuit, a series of errors, we submit, poses a question to be fairly weighed by a supervisory court for the neighbor who lives a foot across the state line in Texarkana, Arkansas, within the Eighth Circuit.

The Solicitor General would dodge the clear requirement of corroboration of opening cash of $2,000.00, which figure is based upon the taxpayers' admission at their first encounter with the Special Agent, *Smith* v. *U. S.*, 348 U.S. 147, by declaring that taxpayers dealt in cash and maintained a much higher standard of living than was indicated by reported taxable income. See Memorandum in Opposition, p. 5.

These taxpayers cashed checks for their patrons, in round figures, totaling $13,800.00 in 1957, $28,000.00 in 1958 and $9,800.00 in 1959. (R. 583) The Special Agent thought so little of these cash transactions that he sampled some 10% of the checks and quit. (R. 585) If the taxpayers had intended to deceive or to hide or conceal their cash transactions we ask why would they have deposited all of their cash in one business bank account? (R. 474; 191-200; 220-224)

As to the charge that willfulness may be implied because the taxpayers spent more money than they reported as *taxable income,* the Solicitor General must

be mindful that, even on the most conservative depreciation basis, the taxpayers experienced depreciation during the years in issue as reflected on their tax returns in the following amounts (R. 166-169; 173-174; Gov. Exs. 4, 5 and 6):

1957	$11,834.01
1958	15,318.10
1959	19,120.20

Thus, in each of these years there was this much cash free of tax which would have been available for use by these taxpayers with impunity to be spent for those few personal items shown, with ominous overtones, at page 3 of the Solicitor General's Memorandum.

We are aware of no cases or rule of law which require or even permit an inference of willfulness and evil purpose in these circumstances. To the contrary, we submit that taxpayers' education, their wholehearted cooperation, the open manner in which they handled their affairs and their banking, their employment of a bookkeeper and a certified public accountant to handle their affairs combined with a business that was so many sided as to be confusing and distracting to them support a conclusion of innocent mistake or at the most negligence in the manner in which they handled their business affairs and reported their taxable income.

In closing it is noted that no response was made by the Solicitor General to the claim in the Petition of the crucial importance of this case in the administration of civil and criminal tax law. Since this Petition was filed the Court of Appeals for the Fourth Circuit by decision entered December 7, 1965 has joined hands with the Fifth Circuit in the *Tomlinson*